



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: December 17, 2002

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You were incorporated on [REDACTED] and applied for recognition under section 501(c)(4) of the Code as a social welfare organization. Your Articles of Incorporation state that your purposes are:

- To promote and encourage the preservation of open space, agricultural lands and natural ecological systems in [REDACTED] or elsewhere in [REDACTED], in cooperation with other non-profit corporations having similar goals;
- To acquire, lease, sell or otherwise deal with tracts of rural or undeveloped land, including sale or donation of land to other non-profit organizations; and
- To engage in any other lawful purpose or purposes permitted under the [REDACTED] Non-Profit Corporation Law of [REDACTED], as amended.

Your by-laws state that you shall have no members and that your affairs shall be conducted and all corporate powers shall be exercised by or under the direction of your Board of Directors, who shall consist of not fewer than three persons, a majority of whom shall be residents of [REDACTED]. Since your incorporation, you have had only three Directors, one of whom is a realtor, and one of whom is the only certified public accountant in the area.

You state that your primary goal is "to preserve the rural character, lands and natural ecological systems of the area and provide for more sensitive, less destructive development...." In order to accomplish this, you intend to organize limited liability partnerships (LLPs) with

individual local residents to buy or otherwise acquire rights to land, subdivide it and sell it, perhaps encumbered by conservation easements and other devices. You have described buying and selling land as your only activity, and your only source of revenue. You will attempt to purchase local property that is not covered by a conservation easement only after the [REDACTED], an organization recognized as exempt under section 501(c)(3) of the Code to protect agricultural lands, has failed or been unable to act. You will "attempt to persuade" the owner to sell to you instead of to a developer. The "land will be acquired using an LLP for each piece of property" and you "anticipate it will require twenty or more partners to make an acquisition." You will then "attempt to resell it as quickly as possible to a buyer or buyers interested in conserving the property." However, "it may be necessary to divide larger parcels into several smaller units." A sample partnership agreement that you submitted states as its purpose: "to assist in the preservation of such property by substantially and permanently limiting the extent to which the Tract may be subsequently developed." It appears from the application that you expect to subdivide parcels and to sell them to ordinary purchasers who would presumably use them for residences or commercial or retail purpose.

You state that your "(r)evenue will be generated by the resale of acquired property." You will not engage in any other activities.

In your letter dated [REDACTED] you state that you will choose the land to acquire using the guidelines established by the *Land Trust Alliance Standards and Practices Guidebook*, and that you will not be involved until the Conservation Committee and the Land Trust "have evaluated" a property. (The Conservation Committee, appointed by the Township Supervisor, is primarily responsible for educating the community regarding conservation opportunities and options.) You stated that the "final determination" will be made by the investors: if enough people in the community want to purchase the land, they will invest in the partnership.

Article 8 of the Partnership agreement contains the allocations of profits and losses. All of the net proceeds are allocated to the investors until initial capital investments are repaid, then until a specified percentage return on initial investment is achieved. Thereafter, [REDACTED] percent of the proceeds are allocated to the limited partners and [REDACTED] percent to you. Special allocations are mentioned, but not specified.

You are named as managing partner. However, Article 19.7 allows partners holding two-thirds of the capital of the partnership to amend or alter the agreement at any time, including amending the authority conferred on the general partner.

#### LAW

Section 501(c)(4) of the Code provides that organizations not organized for profit but operated exclusively for the promotion of social welfare may be exempt from taxation so long as no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Section 1.501(c)(4)-1 of the Income Tax Regulations defines operated exclusively for the

promotion of social welfare as being primarily engaged in promoting in some way the common good and general welfare of the people of the community for the purpose of bringing about civic betterments and social improvements.

Section 170(h) of the Code indicates what conservation activities Congress regards as having a public benefit. It added a definition of "qualified conservation contribution" to the section controlling deductions for charitable contributions. It provides a charitable deduction for donations of land for specified purposes:

- i) the preservation of land areas for outdoor recreation by, or the education of the general public,
- ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,
- iii) the preservation of open space (including farmland and forest land) where such preservation is—
  - a. for the scenic enjoyment of the general public; or
  - b. pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit, or
- iv) the preservation of an historically important land area or a certified historic structure.

In *People's Educational Camp Society*, 331 F. 2d 923 (2d Cir. 1964), the court held that although an organization recognized as exempt under 501(c)(4) of the Code may conduct a business, the business activity may not be so substantial that the business rather than social welfare is the primary purpose of the organization.

Revenue Ruling 69-385, 1969-2 C.B. 123, considers a corporation in which membership is open to all in a particular community for a fee. The organization purchases unimproved lots and sells some of the property on a sporadic basis. The corporation occasionally distributes profits to the members in accordance with the original assessment. The revenue ruling concludes that the distributions were equivalent to dividends and result in profit to the members that is incompatible with the regulations under section 501(c)(4) of the Code.

Revenue Ruling 76-204, 1976-1 C.B. 152, analyzes the public benefit of land preservation. An organization formed by scientists, educators, conservationists as well as community representatives works closely with governments at all levels to identify "ecologically significant" tracts. It is recognized as exempt under section 501(c)(3) of the Code because it acquires and maintains land or transfers it to state or federal governments.

Revenue Ruling 78-384, 1978-2 C.B. 174, on the other hand, holds that a group that owned ordinary farmland and intended to restrict its use to farming and other uses that the organization deemed ecologically suitable is not preserving land of any "distinctive ecological significance." Therefore, the benefit to the public from the self-imposed restriction on its own land is too indirect and insignificant to warrant tax-exempt status under section 501(c)(3) of the Code.

Revenue Ruling 81-116, 1981-1 C.B. 333, holds that an organization that provides free

parking in a city qualifies for exemption under section 501(c)(4) of the Code. The organization's members are businesses, churches, civic organizations, and interested individuals constituting a broad spectrum of the community. It promotes the common good by relieving congestion and increasing patronage of the city, but does not conduct a business because it provides free parking, nor does it favor members by the location of parking.

Revenue Ruling 98-15, 1998-1 C.B. 718, discusses participation by exempt organizations in partnerships with for profit entities. In order to protect the exempt status of the organization under section 501(c)(3) of the Code, the partnership must be organized and operated to promote the exempt purpose of the exempt partner and to allow it to continue to conduct exempt activities exclusively. Structural elements that permit the exempt organization to control the activities of the partnership are mandatory, as are structural protections of the exempt organization's assets.

#### ANALYSIS

Under the facts presented we conclude that you do not qualify as exempt from taxation under section 501(c)(4) of the Code. The real estate development you plan will not promote social welfare because the lands are not considered to be environmentally significant and their use will not be preserved for the public. By your own admission, your primary activity is the conduct of a commercial business: real estate development, rather than promoting the general welfare. Finally, the buying and selling of land through limited liability partnerships with private investors presents a possibility of inurement and private benefit.

In order to be recognized as exempt under section 501(c)(4) of the Code, an organization must be not organized for profit but operated exclusively for the promotion of social welfare. The regulations elaborate upon the statutory definition of social welfare by explaining that it means primarily engaged in promoting in some way the common good and general welfare of the people of the community for the purpose of bringing about civic betterments and social improvements. The emphasis on the "common" good and the "general" welfare distinguishes acceptable benefits to the general public in a particular community from organizations that benefit a select few. Land preservation certainly may result in benefits to a community. Congress has encouraged preservation of natural environments in a number of statutes. The issue is whether you are organized to provide such a benefit to your community.

One important criterion used to distinguish a beneficial preservation program is the kind of land preserved and the way in which it is chosen. As described in Rev. Rul. 76-204, *supra*, an organization that works closely with governments at all levels to identify "ecologically significant" land is exempt. Conversely, a group that is not preserving land of any "distinctive ecological significance" and that provides only an indirect and insignificant benefit to the public from its self-imposed restriction on its own land does not warrant tax-exempt status. Unlike the first organization, you do not plan to identify ecologically significant land either by reference to a clearly delineated government policy, nor by the recommendation of objective and knowledgeable advisors. Your plans more closely resemble the second group in the indirect benefit to the public through some restrictions on ordinary land.

In 1980 Congress addressed the issue of when preservation of land is a public benefit by amending section 170 of the Code to provide a charitable contribution for a qualified conservation contribution. The committee report specifically conditioned the allowance of a deduction upon a contribution of land that would result in a public benefit. "The preservation of an ordinary tract of land would not, in and of itself, yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public enjoyment would yield a significant public benefit." Senate Report No. 96-1007, 1980-2 C.B. 603, 605.

You have not demonstrated any common good or general welfare of the people of the community that would result from your activity. The information that you have submitted does not identify land that has historic, ecological, or agricultural significance. You intend to rely on the assessments of other bodies and that of individual investors who have no responsibility to promote the good of the community as a whole. You do not mention a "clearly delineated ....governmental conservation policy" as a basis for your acquisition decisions. It appears that you would spend much of your time and effort on land lacking in significance for the community.

You do not explain how the community would benefit after the sale of the land: by public access or scientific access to the land, for example. You do not intend to preserve the land, but rather to sell it to developers or owners who may build upon it even though they may be "interested" in conserving the land. The fact that the tracts that you sell would be somewhat larger than a developer would decide to sell does not constitute a public benefit if the lands are still entirely private and not preserved. You assume that the community as a whole would benefit from slower growth, and by restricting new housing to large parcels of land, but do not substantiate this assumption. You have not provided evidence that your activities will bring about civic betterments and social improvement within the meaning of section 501(c)(4) of the Code.

Unlike the organization in Rev. Rul. 81-116, *supra*, you have no membership, and a very small Board of Directors. The broad community involvement in that case resulted in benefits for the entire city: increased patronage of the downtown in general and decreased congestion, in addition to free parking for all. Your use of partnerships makes you more like the organization described in Rev. Rul. 69-385, *supra*, that distributed the profit from land that it bought and sold. Both you and your partners will profit from your real estate transactions.

If you are conducting a business as your primary activity, you cannot be said to be operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Code. Although an organization recognized as exempt under section 501(c)(4) may engage in business activities, these activities must not be so substantial that the business rather than social welfare is the primary activity of the organization. See *People's Educational Camp Society, supra*. By your description, you plan to engage in activity similar to commercial developers and that activity will be your sole activity.

Your organizational structure provides a significant potential for inurement. Of your three directors, one is a CPA and another is a realtor. Constructing LLPs and selling real estate could result in business for both of them. Your conflict of interest provision is not

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sufficient to prevent this, because it allows the director with a conflict to participate in discussion and be counted in the quorum, so long as he discloses the facts. Because you have only three directors, there is no real possibility of independent judgment on such a matter. Another possibility is that a deal would affect land owned by one of the directors. The organization could provide a substantial benefit to a director by changing or reducing the development of a parcel of land in the vicinity of land owned by the director. In answer to a question about this, you replied: "it is impossible to say whether acquisitions and easements would affect board members."

The LLPs through which you intend to operate also pose a risk of private benefit. The partnership agreement is not restricted to exempt purposes. The partnership is structured to repay capital investments and then make a return on investment to the private investment. In addition to the financial benefit, the investors will have the ability to impose limits on the development most likely benefit themselves and the owners of adjacent tracts of land (who are likely to be the same people.) Thus, you will lend your name, your aura of public benefit, and the work by your directors to buy and sell the land in a manner that may benefit private individuals.

For these reasons, you do not promote social welfare and the common good of the community within the meaning of section 501(c)(4) of the Code because your primary purpose is buying and selling of land in the manner of, and in competition with, commercial developers, and because your proposed operation presents the possibility of inurement to the directors and private benefit to individual investors and land owners.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by faxing them to 202-283-8937 or by using the following address:

Internal Revenue Service  
TE/GE [REDACTED]

1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[Handwritten signature]

[REDACTED]  
Acting Manager  
Exempt Organizations  
Technical Group 2

Originated By

Dec 17, 2002

12-17-2002